PETITIONER:
GENERAL INSURANCE CORPORATION OF INDIA .

Vs.

RESPONDENT:
COMMISSIONER OF INCOME-TAX, BOMBAY

DATE OF JUDGMENT: 21/09/1999

BENCH:
S.Rajendra R.C.Lahoti

JUDGMENT:

R.C. LAHOTI, J

General Insurance Corporation of India, the appellant - assessee is 100 % Central Government Undertaking formed as a Government Company under The General Insurance Business (Nationalisation) Act, 1972 (hereinafter G I B Act, for short). It carries on general insurance business in India. At the time of nationalisation, there were 107 companies carrying on the business of general insurance. They were all merged together into four subsidiaries of the appellant Corporation viz. National Insurance Co. Limited, New India Assurance Co. Limited, Oriental Insurance Co. Limited, and United India Insurance Co. Limited. The Central Government contributed to the capital of the appellant in the form of preference shares and equity shares for the purpose of paying compensation to the shareholders and the management of the merged companies. The preference shares were to be redeemed in such time as the Board of Directors of the appellant Corporation may deem fit. The controversy relates to the assessment year 1977-78, corresponding to the accounting year ending 31.12.1976. It is not disputed that the income of the appellant assessee is to be computed under Rule 5 of First Schedule to the Income-tax Act, 1961.

The Income-tax Act, 1961 makes a special provision for computing the taxable income of an assessee engaged in business of insurance. It provides as under:-

Insurance business

44. "Notwithstanding anything to the contrary contained in the provisions of this Act relating to the computation of income chargeable under the head " Interest on securities," " Income from house property", "Capital gains" or "Income from other sources", or in section 199 or in sections 28 to [43 A] the profits and gains of any business of insurance, including any such business carried on by a mutual insurance company or by a co-operative society, shall be computed in accordance with the rules contained in the First Schedule."

Inasmuch as the appellant - assessee carries on business of insurance other than life insurance, we are concerned with Rule 5 of the First Schedule which reads as under:

B- Other insurance business

Computation of profits and gains of other insurance business.

5. The profits and gains of any business of insurance other than life insurance shall be taken to be the balance of the profits disclosed by the annual accounts, copies of which are required under the Insurance Act, 1938 (4 of 1938), to be furnished to the Controller of Insurance, subject to the following adjustments:-

(a) subject to the other provisions of this rule, any expenditure or allowance which is not admissible under the provisions of sections 30 to [43 A] in computing the profits and gains of a business shall be added back;

(b) xxx xxx xxx

(c) such amount carried over to a reserve for unexpired risks as may be prescribed in this behalf shall be allowed as a deduction.

[Note:- Sec. 44 and Rule 5 (a) of First Schedule as reproduced hereinabove are as they stood at the relevant time. Later by the Direct Tax Laws (Amendment) Act 1987 '43 B' has been substituted in place of '43 A' in both the provisions]

The problem is created by Rule 2 (2) (a) of the General Insurance Business (Nationalisation) Rules 1973 (hereinafter G I B Rules, for short) framed by the Central Government in exercise of the powers conferred by Section 39 of the G I B Act, the relevant part whereof reads as under:-

"39. (1) The Central Government may, by Notification, make rules to carry out the provisions of this Act.

(2) In particular, and without prejudice to the generality of the foregoing power, rules made under this Section may provide for :-

(a) the manner in which the profits, if any, and other moneys received by the Corporation may be dealt with."

xxx xxx xxx xxx

Rule 2 (2) (a) referred to hereinabove reads as under:

"2. Profits and receipts of the Corporation and acquiring companies how to be dealt with --

....

(2) (a) In arriving at the net profit of the Corporation, the amount set apart for redemption of preference shares to such extent as the Board of Directors of the Corporation may consider expedient shall be treated as an item of expenditure in the Profit and Loss Account."

In Profit and Loss Account, the appellant assessee had made a debit entry for an amount of Rs.3,00,30,700/- and

transferred the amount to preference share capital redemption account. The Income-tax Officer added back the amount to the income of the assessee on the reasoning that this amount was to be treated as revenue expenditure in view of Rule 2 (2) (a) of G I B Rules. The assessee appealed to the Appellate Assistant Commissioner of Income-tax (Appeals) who agreed with the assessee and deleted the addition in the income following his own order on a similar claim made for the assessment year 1976-77. The department appealed to the Income Tax Appellate Tribunal. The Tribunal followed its own order dated 26.9.1978 in respect of this very assessee for the assessment year 1974-75 and dismissed the appeal. A perusal of the order of the Tribunal (Annexure P-3) for the assessment year 1974-75 shows that in the opinion of the Tribunal the amount set apart as a reserve could not be treated as expenditure or allowance and assuming it to be an amount of expenditure, it was not an item of expenditure dealt with by the provisions of Sections 30 to 43A of the Income-tax Act. Accordingly, the claim of the assessee was liable to be upheld.

On a request made by the Revenue, the following question was referred by the Tribunal for the opinion of the High Court under Section 256 (1) of the Income-tax Act:-

"Whether on the facts and in the circumstances of the case the Tribunal was justified in law in holding that the sum of Rs.3,00,30,700/- being provision for redemption of preference shares was not liable to be added back in the total income of the assessee for the assessment year 1977-78". The High Court has answered the question in the negative, that is, in favour of the Revenue. In doing so, the High Court has purported to treat the question as covered by two decisions of the Supreme Court in Anarkali Sarabhai vs. C.I.T (1997) 224 ITR 422, Associated Power Co. Ltd. vs. C.I.T. (1996) 218 ITR 195, and a decision of the Bombay High Court in Colaba Central Co-operative Consumers' Wholesale and Retail Stores Ltd. vs. C.I.T. (1998) 229 ITR 209 Bom.

The aggrieved assessee has filed this appeal by special leave granted under Article 136 of the Constitution of India.

We have heard Shri T.R. Andhyarujina, learned senior advocate for the assessee - appellant and Shri T.L. Viswanatha Iyer, learned senior advocate for the Revenue. Having heard the learned counsel for the parties, we are of the opinion that the appeal deserves to be allowed.

Section 44 of the Income-tax Act is a special provision governing computation of taxable income earned from business of insurance. It opens with a non-obstante clause and thus has an overriding effect over other provisions contained in the Act. It mandates the assessing authorities to compute the taxable income for business of insurance in accordance with the provisions of the First Schedule. A plain reading of Rule 5(a) of the First Schedule makes it clear that in order to attract the applicability of the said provision the amount should firstly be an expenditure or allowance. Secondly, it should be one not admissible under the provisions of Sections 30 to 43A. If the amount is not an expenditure or allowance, the question of testing its eligibility for adjustment by reference to Rule 5 (a) to the First Schedule would not

arise at all. A perusal of the order dated 26.9.1978 passed in ITA No.2699/1977-78 by the ITAT in the case of this very assessee and relied on and followed by the Tribunal while disposing of the appeal for the assessment year in question (AY 1977-78) shows three submissions having been made on behalf of the assessee before the Tribunal: firstly, that the amount set apart by the assessee for redemption of preference shares was only a reserve or a provision and not an expenditure and therefore its allowability for deduction cannot be considered under Sections 30 to 43A; secondly, assuming it was an expenditure, this expenditure was not of the category of expenditure contemplated in Sections 30 to 43A and therefore unless there was a specific prohibition for such an allowance, the departmental authorities would not be justified in adding back the amount under that clause; and thirdly, if Rule 2(2)(a) of the General Insurance Business (Nationalisation) Rules, 1973 be read as providing that the amount so set apart for redemption of preference shares was an expenditure, the fiction should be taken to its logical conclusion so as to hold that the expenditure was allowable as deduction under Sections 30 to 43A of the Income-tax Act. The Tribunal upheld the contention that the provision made by the assessee was neither an expenditure nor an allowance in the ordinary commercial sense and Rule 5 (a) of First Schedule would have no application at all and further, as admittedly Sections 30 to 43A do not deal with an amount set apart for redemption of preference shares so also the amount could not have been added back.

The term 'expenditure' came up for consideration of this Court in Indian Molasses Company Pvt. Ltd. Vs. Commissioner of Income-tax 1959 (37) ITR 66. It was held :-

""Spending" in the sense of "paying out or away" of money is the primary meaning of "expenditure". "Expenditure" is what is paid out or away and is something which is gone irretrievably. Expenditure, which is deductible for income- tax purposes, is one which is towards a liability actually existing at the time, but the putting aside of money which may become expenditure on the happening of an event is not expenditure."

In Pandyan Insurance Co.Ltd. Vs. CIT Madras (1965) 55 ITR 716 also this Court has held that "expenditure" meant "disbursement" and hence did not include depreciation.

It is therefore clear that the sum of Rs.3,00,30,700/- set apart as provision for redemption of preference shares could not have been treated as an expenditure. It is also not an expenditure or allowance of the nature covered by Sections 30 to 43A of the Income-tax Act, 1961. The question of determining its admissibility by reference to Rule 5 (a) of First Schedule to the Income-tax Act, 1961 does not arise nor could it have been added back by the assessing authority by purporting to exercise power under the said Rule. Rule 2 (2) (a) of GIB Rules undoubtedly speaks of the amount set apart for redemption of preference shares being treated as an item of expenditure in the profit and loss account. However, the purpose and extent of the provision has to be kept in view. These rules have been framed in exercise of the power conferred by clause (a) of sub-section (2) of Section 39 of the G I B Act. The object of these rules is entirely different. These rules lay down the manner in which the profits, if any, and other monies

received by the General Insurance Corporation may be dealt with. The concept behind Rule 2 (2) (a) is to permit the Corporation to enter the amount of reserve in the profit and loss account in the expenditure side which would not have been permissible otherwise because the amount set apart in a reserve cannot be expenditure. The rule puts a stamp of permissibility on something not permissible otherwise. This rule itself is suggestive of the fact that the amount set apart in a reserve is not an expenditure in its commercial sense. The extent of the GIB Rules does not go beyond providing an accounting method. These Rules cannot be pressed into service for altering the basic character of the amount which is not an expenditure. Merely because Rule 2 (2) (a) of GIB Rules permits the amount set apart for redemption of preference shares being debited to the profit and loss account, the amount so set apart does not become the amount of an expenditure for all intent and purposes so as to fall within the meaning of the term 'expenditure' as employed in Rule 5(a) of First Schedule to the Income-tax Act, 1961.

If the view taken by the High Court is accepted there would be a conflict between the provisions of Rule 2(2)(a) of GIB Rules and Rule 5(a) of First Schedule to Income-tax Act. The object of Rule 2(2)(a) is to reduce the amount of profit of Corporation by the amount set apart as reserve by artificially treating the amount of reserve as an item in expenditure column. If the same amount was allowed to be added back to profits under Rule 5(a) of First Schedule to Income-tax Act then the object sought to be achieved by Rule 2(2)(a) abovesaid is defeated. The non-obstante clause with which Section 44 of Income-tax Act opens and gives it an over-riding effect only on the provisions of Income-tax Act would earn an overriding effect on the provisions of another enactment also though the Parliament has not chosen to give Section 44 of the Income-tax Act such an effect. It is to be noted that Section 44 does not say - 'notwithstanding anything to the contrary contained in the provisions of this Act or any other law for the time being in force'.

Nor does the Rule 2(2)(a) of GIB Rules have an overriding effect on the provisions of Income-tax Act. The two provisions contained in two enactments have thus different purposes to achieve. Rule of harmonious construction would therefore sustain neither what the Income-tax officer did nor the view of the law taken by the High Court.

There is another approach to the same issue. Section 44 of the Income-tax Act read with the Rules contained in the First Schedule to the Act lays down an artificial mode of computing the profits and gains of insurance business. For the purpose of income-tax, the figures in the accounts of the assessee drawn up in accordance with the provisions of the First Schedule to the Income-tax Act and satisfying the requirements of Insurance Act are binding on the assessing officer under the Income-tax Act and he has no general power to correct the errors in the accounts of an insurance business and undo the entries made therein.

In the Life Insurance of India Vs. CIT - 1964 (51) ITR 773 SC their Lordships were dealing with the pari materia provisions contained in the Income-tax Act, 1922. The Court analysed the scheme underlying the relevant provisions of the Insurance Act, 1938 and the Income-tax

Act, 1922 and held that where the accounts of an insurance company engaged in insurance business are required to be submitted and approved by the Controller of Insurance, the Income-tax Officer has no power to change the figures in the accounts of the assessee. A.K. Sarkar,J. recorded in his opinion :

"The assessment of the profits of an insurance business is completely governed by the rules in the Schedule and there is no power to do anything not contained in it. The reason may be that the accounts of an insurance business are fully controlled by the Controller of Insurance under the provisions of the Insurance Act. They are checked by him. He has power to see that various provisions of the Insurance Act are complied with by an insurer so that the persons who have insured with it are not made to suffer by mismanagement. A tampering with the accounts of an insurer by an Income-tax Officer may seriously affect the working of insurance companies. But apart from this consideration, we feel no doubt that the language of section 10(7) and the Schedule to the Income-tax Act makes it perfectly certain that the Income-tax Officer could not make the adjustment that he did in these cases."

M.Hidayatullah,J. (as His Lordship then was) observed :

"the Income-tax Act contemplates that the assessment of insurance companies should be carried out not according to the ordinary principles applicable to business concerns as laid down in section 10, but in quite a different manner."

The view so taken has been followed by this Court in Pandyan Insurance Company Ltd. Vs. CIT, Madras 1965 (55) ITR 716 SC and CIT, West Bengal Vs. Calcutta Hospital and Nursing Home Benefits Association Ltd. - 1965 (57) ITR 313 SC. In the later case, their Lordships have also observed : "the balance of profits as disclosed by the accounts submitted to the Superintendent of Insurance and accepted by him would be binding on the Income-tax Officer, except that the Income-tax Officer would be entitled to exclude expenditure other than expenditure permissible under the provisions of section 10 of the Act. It is common ground in this case that the reserves which were added to the balance of profits were not expenditure."

The cases relied on by the High Court have no applicability to the facts of the case and the issue arising for decision herein. In Anarkali Sarabhai's case (supra) , the question arising for decision was whether redemption by a company of a preference share amounts to sale of the shares by the shareholder to the company so as to be taxable for capital gains as amounting to transfer within the meaning of Section 2 (47) of the Income-tax Act, 1961. Their Lordships held that such redemption amounted to a sale and hence was covered by the definition of transfer. In Associated Power Co. Ltd's case (Supra) monies standing to the credit of the contingencies reserve set apart to be utilised by the electricity company to meet expenses or recoup loss of profits arising out of accidents, strikes, or other circumstances etc. were claimed as business expenditure entitled to deduction. It was also submitted that the amount so set apart in the reserve had resulted in diversion of income by reason of an overriding title. Their

Lordships held that the amount had reached the hands of the company and inspite of having been set apart by creating a reserve was still available with the company and therefore could neither be treated as an expenditure nor excluded from computing the income of the assessee by application of the doctrine of diversion of income by reason of an overriding title or obligation. In Colaba Central Co- operative Consumers' Wholesale and Retail Stores Ltd.'s case (Supra) decided by a Division Bench of Bombay High Court also the amount in question was set apart by the society as capital contribution redemption fund. The High Court having examined the nature of the amount and the accounts held that the amount so set apart was neither business expenditure nor liable to be excluded from computation of income by applying the doctrine of diversion of income by overriding title. In our opinion, none of the cases has any applicability to the case at hand. In none of the three cases, the question of determining applicability of Section 44 and the First Schedule of the Income-tax Act arose for consideration.

To sum up, the amount set apart by general insurance corporation for redemption of preference shares and treated as expenditure under Rule

2(2)(a) of General Insurance Business (Nationalisation) Rules, 1973 is so treated for the purpose of Insurance Act, 1938. The reserve is not an expenditure in ordinary commercial sense of the term. It cannot be added back for computing profits and gains of business by including it in 'expenditure not admissible under the provisions of Sections 30 to 43A of Income-tax Act' by reference to Rule 5(a) of the First Schedule to Income-tax Act, 1961. The question referred to the High Court should have been answered in affirmative.

The appeal is allowed. The judgment of the High Court is set aside and in supersession thereof it is directed that the question referred by the Tribunal to the High Court shall stand answered in the affirmative, i.e., in favour of the assessee and against the Revenue. No order as to costs.